For employer use only

Salary sacrifice

A technical guide for employers

This guide explores the different options for setting up salary sacrifice (also known as salary exchange). It takes you through some examples of how it works in practice and examines some of the practical issues to be aware of when introducing salary sacrifice.

Notes.

The examples in this guide are not appropriate for Scottish tax payers.

Four ways to set up a salary sacrifice arrangement

The flexibility around how your employees can use their savings from salary sacrifice means there are a variety of ways you can choose to set up an arrangement. Offering your employees a choice over how they want to use their savings could encourage them to take an active interest in their pension plans.

The following scenarios allow your employees to receive benefits as either increased pension payments or additional take home pay or both.

Payment redirection can be set up so employees benefit from:

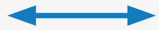
- a boost to their pension provision, or
- increased take home pay, or
- an increase to both their pension payments and take home pay.

Additional Salary Exchange allows employees to:

- exchange additional salary to pay into their pension plans.

Please note this guide is based on our understanding of current tax laws. All the information contained in this guide is correct at the time of going to press. The law and our understanding of it may change in the future, as may the rates and allowances that have been used. Tax treatment depends on an employee's personal circumstances.

1) Payment redirection (increase pension payment)

Scenario 1: Payment redirection	Pension payment	Take home pay
The employee agrees to reduce their gross salary by an amount that ensures their take home pay remains broadly the same. The savings they make in National Insurance contributions (NICs) and any in Income Tax are used to boost pension payments.		

The workings: Based on an employee earning £25,000.00 a year contributing £100.00 a month (from net pay but inclusive of BR tax relief added) into their pension plan. Employee contributions are matched by the employer.

	Before exchange (£)	After exchange (£)
Gross annual salary	25,000.00	23,202.00
Employee pension payment	1,200.00	0.00
Employer pension payment	1,200.00	2,998.00
Income tax	2,486.00	2,126.00
Employee NIC	994.40	850.08
Employer NIC saving	0.00	248.12
Annual take home pay	**20,319.00**	**20,226.00**
Total pension payment (no employer reinvestment)	**2,400.00**	**2,998.00**
Total pension payment (with full employer reinvestment)	**2,400.00**	**3,246.00**

With payment redirection, the employee in this scenario would have their annual take home pay reduced by £93. However, they would be better off through an increase to their pension payment by a minimum of £598.00. You have made savings of £248.12 which you can distribute however you choose. If you were to pass some or all of this saving to your employee, you could further increase their pension payments by up to £248.12, giving a total increase of £846.00.

2) Payment redirection (increase take home pay)

Scenario 2: Payment redirection	Pension payment	Take home pay
The employee agrees to reduce their gross salary by the amount of their current gross pension payment. The savings they make in National Insurance contributions (NICs) are used to boost their take home pay.	↔	↑

The workings: Based on an employee earning £25,000.00 a year paying £100.00 a month (from net pay but inclusive of BR tax relief added) into their pension plan. Employee payments are matched by the employer.

	Before exchange (£)	After exchange (£)
Gross annual salary	25,000.00	23,800.00
Employee pension payment	1,200.00	0.00
Employer pension payment	1,200.00	2,400.00
Income tax	2,486.00	2,246.00
Employee NIC	993.92	897.92
Employer NIC saving	0.00	165.60
Annual take home pay	**20,320.00**	**20,656.00**
Total pension payment (no employer reinvestment)	**2,400.00**	**2,400.00**
Total pension payment (with full employer reinvestment)	**2,400.00**	**2,565.60**

With payment redirection, the employee in this scenario is better off by a minimum of £336.00. You have made savings of £165.60 which you can distribute however you choose. If you were to pass some or all of this saving to your employee, you could increase their pension payments by up to £165.60.

3) Payment redirection (increase pension payment & take home pay)

Scenario 3: Payment redirection	Pension payment	Take home pay
The employee agrees to reduce their gross salary by an amount slightly greater than their current gross pension payments but less than in Scenario 1 and more than in scenario 2. The combined saving in Income Tax and NICs is used to increase both pension payments and take home pay.	↑	↑

The workings: Based on an employee earning £25,000.00 a year paying £100.00 a month (from net pay but inclusive of BR tax relief added) into their pension plan. Employee payments are matched by the employer.

	Before exchange (£)	After exchange (£)
Gross annual salary	25,000.00	23,700.00
Employee pension payment	1,200.00	0.00
Employer pension payment	1,200.00	2,500.00
Income tax	2,486.00	2,226.00
Employee NIC	994.40	889.92
Employer NIC saving	0.00	179.40
Annual take home pay	**20,319.00**	**20,584.00**
Total pension payment (no employer reinvestment)	**2,400.00**	**2,500.00**
Total pension payment (with full employer reinvestment)	**2,400.00**	**2,679.40**

In this scenario, the employee's combined Income Tax and NIC saving is split between take home pay (which increases by £264.00), and pension payment (which increases by £100.00). Your saving of £179.40 could be used to further increase the employee's total pension payment.

In this scenario, the employee has the flexibility to choose how they want to divide their NIC and Income Tax saving between pension payments and take home pay.

4) Salary sacrifice (additional Salary Exchange, increase pension payments)

Scenario 4: Salary Sacrifice, additional Salary Exchange	Pension payment	Take home pay
If the employee wants to pay more into their pension plan then they can specify an additional amount of salary to exchange for a pension payment paid by their employer. Savings in NIC and income tax arising from the additional amount sacrificed can also be used to boost pension payments.	↑	↓

The workings: Based on an employee earning £25,000.00 a year contributing £100.00 a month (from net pay but inclusive of BR tax relief added) into their pension plan. Employee payments are matched by the employer and the employee exchanging an additional £1,000.00 of salary.

	Before exchange (£)	After exchange (£)
Gross annual salary	25,000.00	22,800.00
Employee pension payment	1,200.00	0.00
Employer pension payment	1,200.00	3,400.00
Income tax	2,486.00	2,046.00
Employee NIC	994.40	817.92
Employer NIC saving	0.00	303.60
Annual take home pay	**20,319.00**	**19,936.00**
Total pension payment (no employer reinvestment)	**2,400.00**	**3,400.00**
Total pension payment (with full employer reinvestment)	**2,400.00**	**3,703.60**

By opting to redirect their existing payments as employer payments and deciding to exchange an additional £1,000.00 from their gross salary, the employee noticeably improves their pension payments. Assuming no employer reinvestment, and looking solely at the additional £1,000.00 being exchanged, the employee is effectively trading a £720.00 reduction in take home pay for a boost to their pension provision of £1,000.00. With employer reinvestment, the pension benefit increases to £1,138.00 in respect of the additional £1,000.00 of gross income that the employee has given up.

Including the savings from the employee redirecting their existing payments as employer payments, your total saving in NICs is £303.60. If you were to add all of your saving into your employee's pension, the total pension payment would increase to £3,703.60. This would result in an increase of £1,303.60 compared to pension payments before exchange, with a reduction to the employee's take home pay of only £383.00.

Your NIC savings

You'll make a saving in National Insurance Contributions of 13.8% of the amount of salary in excess of the Secondary Threshold (£9,100 for 2024/25) your employees exchange, and you're free to use this how you wish.

There are a couple of ways that you could use some of this saving to encourage pension take up amongst your staff, and to cover the costs associated with implementing salary sacrifice.

The first is to reinvest some of your savings into your employees' pension plans to further boost their payments. It could pay to offer your staff this incentive, as the more people who sign up to salary sacrifice, the greater your overall NIC saving.

The table below shows how you can reinvest some of your savings to transfer some extra benefit to your employees.

↑ = Employer NIC reinvestment ↑ = Employee NIC reinvestment ↑ = Effect on take home pay

Scenario: Employer reinvestment By distributing some or all of your NIC savings to your employees, you can further boost their pension provision.							
Payment redirection 1		Payment redirection 2		Payment redirection 3		Salary sacrifice	
Pension payment	Take home pay	Pension payment	Take home pay	Pension payment	Take home pay	Pension payment	Take home pay
↑ ↑	↔	↔ ↑	↑	↑ ↑	↑	↑ ↑	↓

You decide on the proportion of your savings to reinvest, but we feel it would be difficult to sell the merits of salary sacrifice to employees if the benefits are weighted heavily in your favour.

A second option would be to use some of your savings to cover the costs of implementing the salary sacrifice arrangement. These costs are likely to arise from additional administration requirements, which are covered in the next section.

Step by step guide to setting up salary sacrifice

Salary sacrifice involves making changes to an employee's contract of employment and there are several steps that need to be followed to satisfy legal requirements. In addition, HM Revenue & Customs (HMRC) take an interest in how tax and NICs are affected.
To avoid confusion, we've summarised the key steps you will have to take to set up a salary sacrifice arrangement. These steps are there as guidance and before doing anything you must seek employment law advice. (A full set of salary sacrifice guidelines can be found on **hmrc.gov.uk**)

- Firstly, you will need to discuss salary sacrifice with your employees, and clearly communicate the benefits and implications. Your adviser can provide you with an employee guide to distribute to employees.
- You might want to include the option to change the arrangement should an employee experience a lifestyle change. This refers to unforeseen life events (divorce/dissolution of civil partnership, pregnancy, redundancy of partner) which could lead to circumstances where the arrangements under salary sacrifice are no longer suitable.
- Participating employees will need to sign their agreement to salary sacrifice (a copy of this agreement should be kept with the employee's original contract). Your adviser can provide you with letters for each of your employees to sign.
- It is essential the arrangement is in place and has been agreed before any salary is exchanged.
- Payslips will need to display the amount of salary exchanged. It is important that this is not accounted for as a deduction. This may create some extra admin for your payroll department and it is worth considering the impact this could have on computer systems and administration processes.
- You must make sure your employees' salaries don't drop below the national minimum wage as a result of salary sacrifice, and great care needs to be taken with employees whose earnings exceed (but are close to) the Primary Threshold, which is the point at which employees start making National Insurance contributions.

Some things to bear in mind

Reducing an employee's salary through salary sacrifice involves making changes to their contract of employment. It is important to be aware of the implications this might have for you and your employees.

Employees

The reduction in salary could affect your **employees' entitlement to statutory benefits**, which could include:

- State pension
- Child tax credit
- Working tax credit
- Universal credit
- Statutory sick pay
- Maternity and paternity pay.

This list extends to encompass a host of **additional salary related benefits**, including:

- Life Assurance
- Bonuses
- Overtime pay
- Redundancy payments
- Benefits on death.

HMRC have more information about the benefits that might be affected on their website **gov.uk/guidance/salarysacrifice-and-the-effects-on-paye**

The way in which pension payments are treated under a salary sacrifice arrangement could affect the **benefits your employees are entitled to on death**. According to Occupational Pension Scheme (OPS) rules, an employee who dies during pensionable service will normally have their payments returned. However, pension payments through salary sacrifice are treated as employer payments, and employees won't be entitled to this return on death.

Currently, a tapered annual allowance applies where an employee's "threshold income" exceeds £200,000 and their "adjusted income" exceeds £260,000. Whether it's through a new or an altered arrangement on or after 9 July 2015, any salary exchanged for an employer pension contribution is still included within the threshold income calculation.

Auto-enrolment

At the moment, we believe that salary sacrifice doesn't work seamlessly with the auto-enrolment process. Employers can't make an agreement for salary sacrifice a pre-condition for auto-enrolment. However, employers can choose to operate salary sacrifice before or after the auto-enrolment process or use it as an alternative contribution basis to a default, unreduced, basis. Alternatively, employers can look into amending contracts of employment to have the same effect as salary sacrifice. Employers may need to take expert advice on salary sacrifice and amending contracts of employment before deciding what they want to do.

Employer

Salary sacrifice is a matter of employment law as it involves changes to an employee's contract of employment, and we strongly suggest you obtain legal advice on whether the proposed arrangement will achieve its desired outcomes and how best to introduce a salary sacrifice scheme.

One step you could take to help alleviate some of the issues your employees may face by accepting a reduced salary would be to **retain a notional salary for each of your employees**. In this instance, their pre-exchange salary may be taken into account by mortgage lenders, and when their entitlement to other salary related benefits are calculated (but not for the statutory benefits mentioned earlier).

We’re here to help

Introducing a salary sacrifice arrangement might seem a little daunting, but we’re here to help make the transition as easy as possible. We’ve developed a suite of support features we encourage you to use. Simply contact your financial adviser who can provide you with a number of useful tools.

These include **employee guides** that explain to your employees the benefits and risks of signing up to salary sacrifice, the options available to them, and some of the issues they should consider. The guides include example cases that talk them through how salary and benefits are affected.

Your adviser can show you our **salary sacrifice calculator**, which can help you to:

- run through the various scenarios available for you to set up salary sacrifice
- calculate how employee salaries are affected by salary sacrifice
- select how you want to use your NIC saving, and see the effect on your employees’ salaries
- produce personalised letters for employees to sign their agreement to salary sacrifice

Please get in touch with your Aviva account manager or financial adviser if you’d like any more information.

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0800 068 6800

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